



## Alaska State Pension Investment Board

P.O. Box 110405  
Juneau, Alaska 99811-0405  
(907) 465-3749

### Message from the Chair

I am pleased to present the 2002 Annual Report of Investments for the period ending June 30, 2002 to you, the participants and beneficiaries of this retirement trust fund.

The difficult financial market environment experienced in fiscal 2001 continued throughout fiscal 2002. The 2000-2002 bear market now ranks as the worst in modern financial market history. For the twelve months, U.S. stocks registered a loss of -18.0% as measured by the Standard & Poors' 500 Stock Index. Small cap stocks, as measured by the Russell 2000 Stock Index (comprised of the smallest 2000 of the top 3000 companies ranked by market capitalization), lost -8.6% for the 12 months. International stocks, as measured by the MSCI EAFE Index, declined -9.5%. As was the case in fiscal 2001, the only bright spots were high quality investment grade bonds and real estate. The Lehman Aggregate Index, a measure of the investment grade bond market, benefited from the decline in interest rates and returned a positive +8.6% while various measures of the real estate market produced returns in excess of +5%.

While it is never pleasant to lose money, particularly for two years in succession, it is encouraging and reassuring to observe the benefits of prudent diversification. TRS experienced an overall negative return of -5.5% for the 12 months ended June 30, 2002. The System's total domestic equity composite declined -16.8%, which was better than broad measures of the total domestic equity market. For example the Russell 3000 Stock Index declined -17.2%. The System's international equity composite declined -8.2%. This result was better than the MSCI EAFE Index loss of -9.5% but also significantly better than the domestic equity result. Thus, the decision to have meaningful international equity exposure helped dampen the global equity market decline. Similarly, while the System's domestic bond portfolio slightly underperformed its benchmark index (positive +8.2% for the portfolio and +8.6% for the index) the decision to maintain significant bond exposure contributed importantly to minimizing losses. TRS's real estate portfolio also helped overall results by posting a positive +5.2% return. The biggest bright spot was the performance of the System's international bond portfolio. The portfolio enjoyed a +22.6% return much of which was attributable to the weakness in the value of the U.S. dollar during the fiscal year. In total, the TRS negative return during FY02 of -5.5% was below its target return of negative -4.4%. The primary explanatory factor was a slight over target allocation to equities. A secondary factor was the underperformance of the U.S. bond portfolio and the small cap equity composite relative to their respective market benchmarks.

It is critical to remember that the System's assets are invested for the long-term. Our objective is to produce a very competitive long-term return that meets the System's funding requirements at an acceptable risk level. We, therefore, are encouraged to observe that the 10  $\frac{3}{4}$  year cumulative annualized return (the longest period available) of +8.6% compares favorably with the System's policy target index return of +8.45% and the actuarial earnings assumption.

The trustees work hard to achieve an asset mix that provides the highest expected return for a given level of risk. Working closely with our dedicated staff in the Department of Revenue and our investment advisors and consultants, we established an investment mix that we believe will provide enhanced returns while maintaining a prudent level of risk. The asset allocation plan adopted by the trustees for FY02 called for an investment distribution as follows: 41% in domestic equities, 18% in international equities, 31% in domestic fixed income, 3% in international fixed income, and 7% in real estate. This asset allocation is reviewed annually and has been slightly modified for the new fiscal year. It, however, is designed to provide competitive returns at a reasonable level of risk. Fiscal 2002 results were within the range of shorter-term returns envisioned as possible.

ASPIB represents over 60,000 participants and beneficiaries. The trustees strongly believe that you should be kept well informed about the performance of your retirement funds, and about what we as fiduciaries are doing on your behalf. To this end, we are proud of the ASPIB web site, which can be accessed at <http://www.revenue.state.ak.us/treasury/aspib/index.htm>. We continue to encourage member participation at our meetings, and welcome your letters and comments.

On behalf of all the trustees, thank you for giving us the opportunity to serve as your fiduciaries.

Jeffrey E. Sinz, Chair

A handwritten signature in black ink, appearing to read "Jeffrey E. Sinz".

## ALASKA STATE PENSION INVESTMENT BOARD

(as of June 30, 2002)



**Jeffrey E. Sinz, Chair**

Appointed by the Governor

Jeffrey E. Sinz, Chair, was appointed to the board in 1998 by Governor Knowles. Mr. Sinz is currently employed as Director of Finance for the Kenai Peninsula Borough. He has over twenty years experience in public sector finance, including thirteen years with the Municipality of Anchorage. While at the Municipality, he served as Municipal Accounting Officer, Director of Finance for the Anchorage Telephone Utility, Finance Manager for the Solid Waste Services Utility, and a Senior Budget Analyst for the municipal general government. He also worked as a financial planner and supervisor with the Alaska Railroad Corporation and as a financial administrator with a Wisconsin public school district. Jeff also serves as vice president of the Alaska Municipal League Investment Pool Board of Directors. He has an MBA in Management from the University of Alaska Anchorage and a BBA in Finance from the University of Wisconsin Eau Claire. His term expires December 31, 2004.



**William "Riley" Snell, Vice Chair**

Appointed by the Governor

William (Riley) Snell, Vice Chair, was appointed to the board by Governor Knowles. Mr. Snell has held numerous positions in State government. He served as the Executive Director of the Alaska Industrial Development and Export Authority (AIDEA) from July 1992 until November of 1996 overseeing banking and development programs. Four years prior to the Executive Director position, Riley served as Deputy Director-Development at AIDEA. From 1985 until July 1989 he served as Deputy Commissioner for the Central Region of the Department of Transportation and Public Facilities. Riley possesses over 27 years of experience in State Transportation and Public Facilities Development and Public Financing. Currently Riley is Vice President and General Manager of Cable and Entertainment for General Communications Inc. (GCI). His responsibilities at GCI include CATV product management as well as construction and maintenance of all outside plant facilities for the company. Mr. Snell's term expires December 31, 2002.



**Gail R. Schubert, Secretary**

Appointed by the Governor

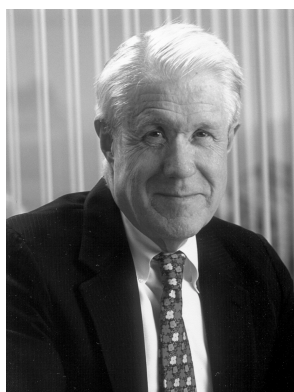
Gail R. Schubert, Board Secretary, was appointed to the board by Governor Knowles. She is currently a member of the law firm of Foster, Pepper Rubini & Reeves LLC in Anchorage. Her practice includes health care and fisheries issues, tax, estate planning, and corporation law. From 1992 to 1995, Mrs. Schubert practiced law at Birch, Horton, Bittner & Cherot, and prior to that, from 1982 to 1992, Mrs. Schubert practiced law in New York City at the firms of Rogers & Wells; Fried and Frank, Harris, Shriver & Jacobson; and at the Federal Reserve Bank of New York. Mrs. Schubert attended the School of Law at Cornell University; the Johnson School of Management (MBA) at Cornell; and Stanford University. She serves as Chair of Board of the Alaska Native Heritage Center and of Akeela Treatment Services, Inc., and on the boards of the Bering Straits Native Corporation, the Alaska Federation of Natives, Khoanic Broadcast Corporation, Alaska Native Justice Center, and is a member of the Anchorage Downtown Rotary. Ms. Schubert's term expires December 31, 2003.



**Gary M. Bader**

PERS Representative

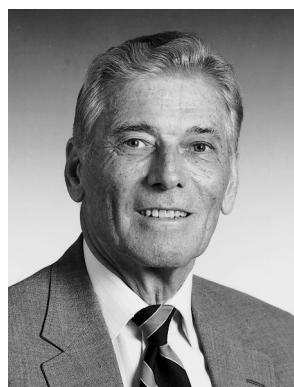
Gary M. Bader was elected by the Public Employees' Retirement System. Mr. Bader has held numerous positions in State government including three years in the Office of Management and Budget and seven years in the Department of Administration, where he was Deputy Commissioner and Director of Retirement and Benefits. He is currently Superintendent of Schools for the Juneau School District. Mr. Bader has a B.S. in Business Administration and a master's degree in Education Administration. He was previously employed with a major Wall Street investment firm where he was licensed with the New York Stock Exchange. Mr. Bader's term expires December 31, 2002.



### **Wilson L. Condon**

Statutory Representative

Wilson L. Condon was appointed Revenue Commissioner in February 1995. He oversees an agency that has very diverse responsibilities, including tax collection, investing state funds, child support enforcement and distributing permanent fund dividends. He was a partner in a private law firm from 1983-1995. Wilson was lead counsel for the state in a series of oil and gas royalty and tax cases. He served as Attorney General from 1980 - 1982 and as Deputy Attorney General from 1975 - 1980. He holds an A.B. Political Science degree and a J.D. degree from Stanford University. As Revenue Commissioner, he also sits on nine boards, including the Board of Trustees of the Alaska Permanent Fund Corporation.



### **Merritt C. Olson**

TRS Representative

Merritt C. Olson served as a member of the Teachers' Retirement System Board for 14 years, a portion of that time as Chair. He has been an Alaska resident since 1953 and resides in Anchorage. Appointed by Governor Egan to serve on the committee that organized the Student Loan Fund, he also served as a member of AARP's State Legislative Committee. Now a retired secondary mathematics teacher from the Anchorage schools and adjunct instructor of psychology at Alaska Methodist University and the University of Alaska, Anchorage, Mr. Olson earned his Ph.D. from Rutgers University and was a Fulbright Scholar in 1957-58. He is Past President of NEA-Alaska/Retired and served on the NEA-Retired (national) Advisory Council for six years. Mr. Olson's term expires December 31, 2003.



### **James "Pat" Wellington**

PERS Representative

James "Pat" Wellington was elected by the Public Employees' Retirement System. Mr. Wellington was born in Ketchikan, Alaska and graduated from Douglas High School. He served two years in the U.S. Army and started his law enforcement career with the Seward Police Department in late 1955. He served as Deputy U.S. Marshal, Alaska State Troopers, Chief of Police of Juneau, Deputy Commissioner and Commissioner of the Department of Public Safety, and retired in 1977 as Director of the Alaska State Troopers. Mr. Wellington is also the Chairman of the Public Employees' Retirement Board. He resides in Anchorage. Mr. Wellington's term expires December 31, 2004.



### **Dorothy Wells**

TRS Representative

Dorothy Wells was elected by the Teachers' Retirement System. A resident of Alaska for 37 years, Ms. Wells is a retired teacher who taught business education at Eielson Air Force Base, and business classes for the University of Alaska night school program at Eielson. She obtained her B.S. degree from the University of Minnesota/Minneapolis and did graduate work both there and at the University of Alaska/Fairbanks. Mrs. Wells served on the Teachers' Retirement Board for 20 years, and is active with NEA-Alaska/Retired. Her term expires December 31, 2005.

**Department of Revenue  
Treasury Division  
Staff  
(as of June 30, 2002)**

**Commissioner**  
Wilson L. Condon

**Chief Investment Officer**  
Lee E. Livermore, CFA

**Investment Officers**  
Bob G. Mitchell, CFA, Marketable Debt  
Stephen R. Sikes  
Philip Bartlett  
Michael T. Oliver, CFA, Alternatives  
Maria E. Tsu, CFA

**Deputy Commissioner**  
Neil Slotnick

**Comptroller**  
Betty Martin, CPA

**ASPIB Liaison Officer**  
Judy Hall

**Cash Management**  
Michelle M. Prebula, MBA, CPA, CCM

**External Money Managers and Consultants**

**Investment Consultants**

Callan Associates Inc.  
*Denver, CO*  
The Townsend Group  
*Denver, CO*

**Domestic Fixed Income**

BlackRock Financial Management, Inc.  
*New York, NY*

**Domestic Equity Large Capitalization**

Capital Guardian Trust Co.  
*Los Angeles, CA*  
Dresdner RCM Global Investors  
*San Francisco, CA*  
McKinley Capital Management, Inc.  
*Anchorage, AK*  
Tukman Capital Management, Inc.  
*San Francisco, CA*

**Domestic Equity Small Capitalization**

Capital Guardian Trust Co.  
*San Francisco, CA*  
John McStay Investment Counsel  
*Dallas, TX*  
Trust Company of the West  
*New York, NY*

**Domestic Equity Index Fund**

State Street Global Advisors  
*Boston, MA*

**Domestic Enhanced Index**

Invesco Capital Management, Inc.  
*New York, NY*

**Emerging Markets**

Capital Guardian Trust Co.  
*Los Angeles, CA*  
J.P. Morgan Fleming Asset Management, Inc.  
*New York, NY*

**Global Equity**

Lazard Freres Asset Management  
*New York, NY*

**International Equity—EAFE**

Bank of Ireland Asset Management (US) Ltd  
*Santa Monica, CA*  
Brandes Investment Partners, L.P.  
*San Diego, CA*  
Capital Guardian Trust Co.  
*Los Angeles, CA*

## External Money Managers and Consultants (con't)

### International Fixed Income

Delaware International Advisers Ltd.

*London, England*

### Private Equity

Abbott Capital Management, L.P.

*New York, NY*

Pathway Capital Management, LLC

*Irvine, CA*

### Performance Measurement

Callan Associates Inc.

*Denver, CO*

### Real Estate Management—Commingled Funds

Heitman Capital Management

*Chicago, IL*

J.P. Morgan Investment Management Inc.

*New York, NY*

Sentinel Real Estate Corporation

*New York, NY*

UBS Realty Investors, LLC

*Hartford, CT*

### Real Estate—Core Separate Accounts

PM Realty Advisors

*Newport Beach, CA*

Sentinel Real Estate Corporation

*New York, NY*

UBS Realty Investors, LLC

*San Francisco, CA*

### Real Estate—Value Added Separate Accounts

Invesco Realty Advisors

*Dallas, TX*

Lowe Enterprises Investment Management Inc.

*Los Angeles, CA*

### Supplemental Benefits System

Barclays Global Investors, N.A.

*San Francisco, CA*

Capital Guardian Trust Company

*Los Angeles, CA*

Citizens Funds

*Portsmouth, NH*

State Street Global Advisors

*Boston, MA*

T. Rowe Price Investment Services

*Baltimore, MD*

### Deferred Compensation

Barclays Global Investors

*San Francisco, CA*

Capital Guardian Trust Company

*Los Angeles, CA*

T. Rowe Price Investment Services

*Baltimore, MD & Glen Allen, VA*

### Global Master Custodian

State Street Corporation

*Boston, MA*

### Investment Advisory Council

Shlomo Benartzi

*Los Angeles, CA*

Jerrold Mitchell

*Wayland, MA*

Timothy O'Brien

*Denver, CO*

### Independent Auditors

KPMG LLP

*Anchorage, AK*

### Legal Counsel

Wohlforth, Vassar, Johnson & Brecht

*Anchorage, AK*

## Teachers' Retirement System Investment Report

The Investment Report was prepared by the State of Alaska, Department of Revenue, Treasury Division.

### INVESTMENTS

The investment of pension funds is a long-term undertaking. On an annual basis, ASPIB reviews and adopts an asset allocation strategy to ensure the asset mix will remain at an optimal risk/return level given the System's constraints and objectives. During FY02, ASPIB's adopted asset allocation included 41% in domestic equities, 18% in international equities, 31% in domestic fixed income, 3% in international fixed income, and 7% in real estate.

For FY02, TRS' investments generated a -5.5% rate of return. The TRS annualized rate of return was -0.5% over the last three years and +4.6% over the last five years.

The basis of presentation for the data reported in the investment section is in accordance with the Association for Investment Management and Research (AIMR) Performance Presentation Standards.

### INVESTMENT OVERVIEW

For FY02, TRS suffered a decline in value of -5.5%, a continuation of the -5.4% return earned in FY01. The annualized return for the last five years was +4.6%, below the 8.25% actuarial assumption rate.

The well-diversified TRS investment portfolio muted the impact of the bear market in equities that began in the spring of 2000. For the year, the U.S. equity portfolio fell -16.8% and the international equity portfolio dropped -8.2% (versus losses of -12.2% and -16.9%, respectively in FY2001). Positive performance was provided in the U.S fixed-income market, which generated a +8.2% return in FY02,

down from last year's return of +11.9%. The system's real estate investments also continued to provide positive returns.

ASPIB continued the systematic increase in TRS' investments in real estate and private equity. The real estate portfolio earned +5.2% for FY02 versus +11.4% in FY01. The private equity market weakened in FY02 in sync with the public equity markets. TRS' investments in private equities lost -17.0%, down from +1.0% earned in FY01. Over the past five years, TRS' real estate investments have earned an average of +10.6% per year. TRS' private equity investments have broken even over the last three and one quarter years, the amount of time TRS has invested in this asset class.

### DOMESTIC ECONOMY

The U.S. economy continued its struggle during FY02. It entered a recession during the last quarter of FY01 (April to June 2001) as businesses began to spend less on capital goods. The events on September 11, 2001 exacerbated the slowdown. The terrorist attacks on the World Trade Center succeeded in throwing the financial markets into chaos, closing the bond and stock markets for almost a week before they limped back into operation. Americans were collectively glued to their television sets assessing the possibility of further attacks and developments in the war in Afghanistan. Shopping malls, aircraft flights and hotel rooms were sparsely populated during the weeks following the attacks.

In addition, in one of the most spectacular developments in business history, Enron collapsed during November and December of 2001. The fraud and conflict of interest accusations leveled on Enron's senior management, board of directors, and "independent" auditors called into question the accuracy of Corporate America's financial statements and credit analysis.



## Teachers' Retirement System Investment Report

Employment statistics demonstrated a downward shift in momentum during FY02. Last year the economy lost an average of 111,670 jobs a month compared to creating 15,250 new jobs per month in FY01 and 269,000 new jobs per month in FY00. The overall unemployment rate rose from 4.6% to 5.9%.

By historical standards, the U.S. recession was relatively mild and short-lived. The economy actually expanded by 3.2% during FY02, compared with 2.3% for FY01. As the immediate threat of terrorist attacks waned, consumer sentiment improved. Consumers, who account for two-thirds of economic activity, provided a much needed boost to GDP.

Generation-low mortgage rates spurred consumers to purchase new houses. Sales of new homes totaled 914,580 in FY02 up from 912,000 the year before. Sales of existing homes also remained strong at 5.457 million units, virtually tied with the 5.228 million units pace of FY01. The highest recorded pace of housing sales occurred in FY99 at 5.5 million units. Auto sales held up, averaging just under 16.92 million units in FY02 compared to a pace of 16.95 million units in the more robust climate of FY01. Overall retail sales growth slowed to a more modest 3.6% pace from the 3.9% pace seen during FY01.

Worries about inflation continued to subside in FY02. The Consumer Price Index (CPI) rose only +1.1% in FY02 compared to +3.2% in FY01. The Producer Price Index (PPI) dropped -2.1% in FY02 versus +2.6% rise last year. On average, energy prices were lower in FY02 than in FY01. West Texas Intermediate (WTI) crude averaged \$23.27 per barrel last year compared to \$24.10 in FY01. More interesting was the trip these prices took during the year. Oil prices dropped from the \$24 to \$25 range during the summer and early fall of 2001 down to the low \$19 area during the depths of economic uncertainty in November 2001. Rising tensions on the West Bank, concerns over a military conflict between India and Pakistan and possible

war between the United States and Iraq, gave a lift to oil prices. WTI finished FY02 at \$26.44 per barrel.

The weakening economy forced the Federal Reserve to continue the easing it began in January 2001. The Federal Reserve's discount rate was cut five times between July and December of 2001 from 3.75% to 1.75%. The Fed hoped to stimulate the ailing economy and to provide liquidity to the financial markets following the terrorist attacks. In addition, on October 31, 2001 the U.S. Treasury suspended scheduled issuance of 30-year Treasury bonds. This increased the scarcity value of longer maturity Treasuries and helped to lower long-term financing rates. This move aided both businesses and consumers. Lower long-term Treasury rates translated into lower long-term borrowing costs for companies and lower mortgage rates for homeowners. Lower overall interest rates spurred record corporate bond issuance as well as strong home sales and mortgage refinancing volumes.

### EQUITIES

The bear market in equity prices hit the TRS portfolio for the second consecutive year. The domestic stock portfolios declined in value by -16.8% last year on top of a decline of -12.2% during FY01. This decline pulled the annualized return for the last five years down to +3.1% in FY02 from +12.3% in FY01.

Domestic equity performance reflected the slowdown in the economy, reduced growth expectations and shaken investor confidence following the Enron accounting scandal. Large-cap managers underperformed small-cap managers, and value managers outperformed growth managers. Small-capitalization stocks continued their relative outperformance, outdoing their mid and large-cap stock cousins by a significant margin. For the year, the median large-cap manager experienced a decline of -16.7%. The average mid-cap manager lost -12.2% and the average small-cap

## Teachers' Retirement System Investment Report

manager lost -5.6%. The S&P 500 Index experienced a loss of -18.0% for the year. Small-cap value managers were the best performing group with median returns of +10.4% during the year. Large-cap growth managers barely edged out small-cap growth managers to be the worst performing group with returns -22.1% during the year.

Returns for international managers were generally poor as well. The Japanese equity market experienced brutal returns during the year. The median Japan-only manager lost -16.5% over the year. In contrast, the median emerging market manager earned +2.7% during FY02 despite a debt default in Argentina and increasing talk of a bailout of Brazil by the International Monetary Fund.

Pacific Basin median manager returns improved to a -10.4% loss (vs. -28.6% last year) and European managers lost -6.9% (compared to -22.8% in FY01). For the year, the median core-international equity manager lost -8.4%, an improvement from the -22.5% loss reported last year.

As for TRS, its international equity portfolio fared better than the Morgan Stanley EAFE Index with a decline of -8.2% versus -9.5%. The annualized return for the past five years was +1.2%, much better than the -1.6% result for the index.

### FIXED INCOME MARKET

The domestic fixed-income portfolio represented approximately 32% of the total assets of TRS as of June 30, 2002. The fixed-income portfolio uses a core-oriented strategy investing in U.S. Treasury securities, U.S. government agency securities, investment-grade corporate bonds, and mortgage-backed securities. The benchmark for the TRS bond portfolio is the Lehman Brothers Aggregate Bond Index.

The slowing domestic economy guided interest rates lower, which translated into good news for bond investors. The 10-Year U.S. Treasury yield

dropped from 5.32% to 4.78% during FY02, reaching a low of 4.17% in early November of 2001. However, the news was not all good in the bond market. The collapse of companies such as Enron, Quest and WorldCom, coupled with scandals at the likes of Tyco and Adelphia Communications helped to increase the perceived risk of corporate bonds. Ratings agencies became noticeably more conservative in their ratings methodologies, placing pressure on credit ratings. Slowing revenue growth expectations, combined with historically high corporate debt levels and more vigilant ratings agencies resulted in a high level of ratings downgrades. The volume of corporate bonds downgraded to junk status, known as "fallen angels," increased to record levels during FY02.

Lower interest rates drove down the rate charged on mortgages. As a result, mortgage refinancing activity soared during November and December of 2001, and again in June 2002.

For all of FY02, the TRS domestic bond portfolio gained +8.2%, compared to +11.9% the year before. The Lehman Brothers Aggregate Bond Index returned of +8.6% during FY02 and +11.2% in FY01.

The international fixed-income portfolio represented just about 3% of the total assets of TRS. During FY02, the international bond portfolio earned +22.6%, far surpassing the +15.7% posted by the Salomon Brothers Non U.S. Government Index. This compares to results for FY01 of -5.7% and -7.4%, respectively.

The relative weakness of the U.S. economy and the weakening value of the dollar made it easier going for international fixed-income markets in FY02. The Euro reversed its trend of weakening versus the dollar in FY02. During FY01 the Euro fell 11% to \$0.849 but by June 30, 2002 it closed at \$0.9776, up 15.2% for FY02. The Japanese Yen also appreciated in value, improving by 3.9%. On July 1, 2001 one dollar could buy 124.65 Yen, but by June 30, 2002 it could only buy 119.73 Yen.



## Teachers' Retirement System Investment Report

### PRIVATE MARKETS (REAL ESTATE AND PRIVATE EQUITY)

Private market investments or "Alternative Investments" are used in a portfolio to improve over-all portfolio returns in the long term. The volatility and return characteristics of these investments are not directly correlated to return characteristics of stocks and bonds.

At the end of FY02, TRS had 10.4% of its portfolio in private markets, compared to a target of 12%. The total market value of the private market portfolio decreased by -3.8% to \$386.0 million. The decrease was due to sale of real estate properties in excess of new investments and declines in the values of the private equity and real estate investments.

### REAL ESTATE

At the end of FY02, TRS had 7.8% of its portfolio invested in real estate, well within its target of 7% (+/- 2%). At fiscal year end, the real estate portfolio totaled \$289.0 million. The total return for real estate, net of fees, was 5.2% compared to 11.4% for FY01. The income component of return was partially offset by a modest decline in the value of the real estate portfolio. The three and five year total returns were 8.6% and 10.6%, respectively.

Due to the recession and subsequent slow recovery, real estate experienced an unprecedented decline in demand in FY02 in the four major property types, resulting in increasing vacancies, declining rents and lower returns. For example, never in the history of U.S. real estate has the absorption of available space declined for any two consecutive quarters for any property type. However, in March 2002, negative absorption was experienced in the office and industrial markets on a national basis for the fifth consecutive quarter. The hardest hit property type was office, where national vacancy rates doubled to nearly 16%. Industrial properties were similarly affected, but to

a lesser extent. Higher vacancies in apartments were the result of the strong single family housing market. However, the good news is that new construction market for income producing property has declined dramatically in response to the above factors. Thus, supply and demand, in most markets, is only modestly out of balance and the markets should recover as the economy, job growth and resultant demand improve.

While the total real estate return declined from FY01 to FY02, the income component of the return remained stable. This stability factor contributes to the lower volatility of this asset class. Real estate's high and stable income component is the major reason why this asset class is included in the TRS' portfolio. Based upon budgets submitted by the real estate advisors, it is expected that income will grow modestly over the next two years. This income growth and a rise in acquisition volume should provide increased total returns in the future.

### PRIVATE EQUITY

At year-end FY02, TRS' investment in private equity amounted to 2.6% of its portfolio. The estimated market value was \$97.0 million and the total return was -17.0 %. Total returns since inception now amount to 0.0%.

Private Equity investments also experience investment cycles. Capital raised, the number of deals and investment disbursements reached record levels during 1999, 2000 and the first half of calendar 2001. Initial Public Offerings (IPOs), especially for technology-oriented issues, were also at record levels and the NASDAQ market attained a high of 5,048.62 on March 10, 2000. These factors resulted in sharply increasing valuations of private equity investments, the ability to realize profits on some of these investments in a shorter than normal period of time, unrealistic expectations for company prospects, and created what is now referred to as the "technology bubble."

## **Teachers' Retirement System Investment Report**

FY02 witnessed a sharp reversal of these trends, with new capital raised, deal flows and disbursement volumes falling dramatically. By FY02 year-end the NASDAQ market had declined 73% from its high, reducing the valuations of many private equity investments. The combination of falling valuations and a dramatic slowdown in IPO activity caused returns to decline significantly last year.

The private equity markets are now and are expected to be for the foreseeable future more normal with respect to the pace of raising capital, investments and return realization. New deal activity, while low compared to recent times, has begun to pick up. The IPO market, especially healthcare

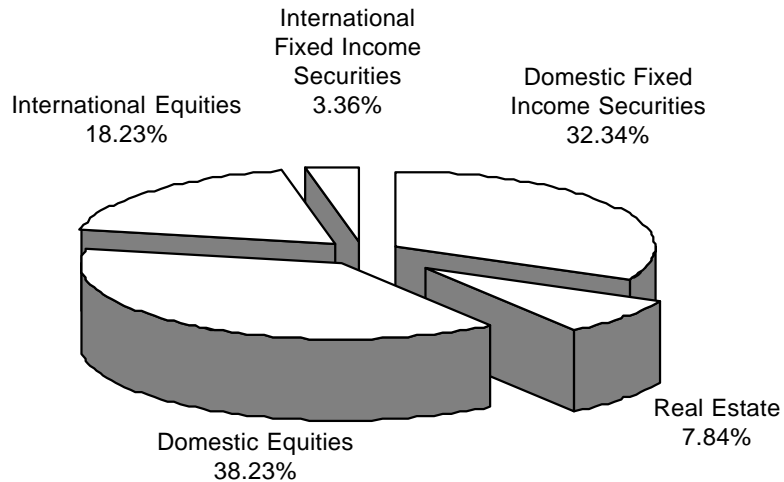
issues, has also shown some, albeit small, recovery. In addition, industry observers expect rising investments to replace technology equipment based upon historical spending patterns.

Results of private equity investments are measured over long periods of time because of the nature of the investment. According to Venture Economics, private equity returns for the year ended March 31, 2002 (the latest data available) were -14.6%, while the three, five and ten year returns were +10.0%, +13.5% and +16.6%, respectively. As the economy recovers, private equity returns are expected to once again be attractive.

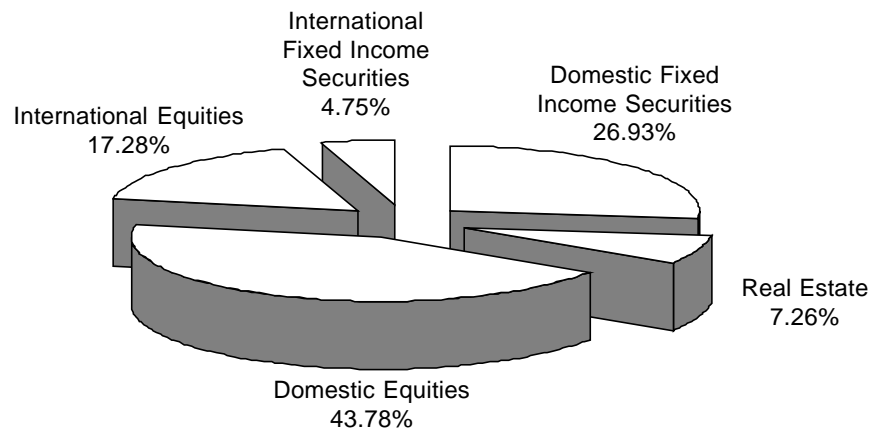
<b>Teachers' Retirement System</b> <b>Schedule of Investment Results</b> <b>Fiscal Years Ended June 30</b>							
	1998	1999	2000	2001	2002	Annualized	
						3 Year	5 Year
<b>Total Fund</b>							
TRS	14.83%	10.67%	10.15%	(5.35%)	(5.49%)	(0.49%)	4.60%
<i>Actuarial Earnings Rate</i>	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%
<b>U.S. Common Stock Returns</b>							
TRS Domestic Equities	24.21%	16.56%	10.41%	(12.20%)	(16.85%)	(6.93%)	3.14%
<i>S&amp;P 500</i>	30.27%	22.76%	7.24%	(14.83%)	(17.99%)	(9.18%)	3.66%
<b>International Stock Returns</b>							
TRS International Equities	0.66%	14.75%	20.59%	(16.92%)	(8.24%)	(2.76%)	1.21%
<i>Morgan Stanley Capital International EAFE</i>	6.10%	7.62%	18.11%	(23.83%)	(9.49%)	(6.78%)	(1.55%)
<b>Domestic Fixed Income</b>							
TRS	11.52%	2.28%	4.56%	11.93%	8.16%	8.18%	7.62%
<i>Lehman Brothers Aggregate Index*</i>	11.28%	2.69%	1.69%	11.22%	8.63%	8.12%	7.63%
<b>International Fixed Income</b>							
TRS	0.36%	5.27%	(3.27%)	(5.68%)	22.56%	3.80%	3.39%
<i>Salomon Non-U.S. Government</i>	0.89%	4.87%	2.42%	(7.43%)	15.73%	3.14%	3.03%
<b>Real Estate Equity</b>							
TRS	16.99%	10.56%	8.43%	11.37%	5.24%	8.59%	10.62%
<i>NCREIF</i>	17.21%	11.24%	11.61%	11.15%	5.60%	9.56%	11.74%
<p>S&amp;P 500 = Standard &amp; Poor's Domestic Equity Stock Index  EAFE = Europe, Australia, and Far East Stock Index  NCREIF = National Council of Real Estate Investment Fiduciaries Index</p> <p>The calculation of investment results were prepared using a time-weighted rate of return based on the market rate of return in accordance with the Association for Investment Management and Research (AIMR) Performance Presentation Standards.</p> <p><i>*Lehman Brothers Government/Corporate Index prior to 3/31/2000.</i></p>							

**Teachers' Retirement System Trust Fund  
Actual Asset Allocation**

**June 30, 2002**



**June 30, 2001**



**Alaska State Pension Investment Board  
Top Ten Holdings by Asset Type  
June 30, 2002**

Invested assets under the fiduciary responsibility of the Alaska State Pension Investment Board (ASPIB) have been commingled in various investment pools to minimize costs and maximize returns. Treasury Division has created nine different mutual fund-like pools to accomplish the investment asset allocation policies of the ASPIB. Using investment pools increases investment efficiency in three ways. First, combining individual funds' cash inflows and outflows to offset each other reduces the amount of cash on hand needed to support daily operations. Treasury can thus increase the return on funds not needed for daily cash operations. Second, pooling investments significantly reduces accounting, budgeting and administrative costs. Finally, the ASPIB can achieve economies of scale by making available investment options that could not otherwise be practically provided for smaller retirement funds. Following are the ten largest bond holdings and the ten largest equity holdings by market value.

	Rank	Fair Value	Par Values/ Shares	Security	Coupon	Due	Credit Rating
<b>Bonds</b>	1	117,413,683	115,820,000	U.S. Treasury Note	4.375%	5/15/2007	Aaa
	2	105,346,041	81,625,000	U.S. Treasury Bond	8.125%	8/15/2021	Aaa
	3	70,301,834	68,754,850	Federal National Mtg. Assn.	6.500%	5/1/2029	Aaa
	4	66,071,010	60,903,360	U.S. Treasury Note	4.250%	1/15/2010	Aaa
	5	50,115,139	47,771,471	Fed Home Loan Mtg. Corp.	7.500%	10/1/2031	Aaa
	6	47,681,745	43,675,000	U.S. Treasury Note	6.750%	5/15/2005	Aaa
	7	43,806,250	43,000,000	Federal National Mtg. Assn.	6.500%	12/1/2099	Aaa
	8	36,222,488	35,995,000	U.S. Treasury Note	3.000%	2/29/2004	Aaa
	9	35,476,064	34,266,127	Federal National Mtg. Assn.	7.000%	7/1/2031	Aaa
	10	35,438,972	35,033,980	Fed Home Loan Mtg. Corp	5.500%	1/1/2009	Aaa
<b>Equities</b>	1	86,993,130	2,994,600	General Electric Co.			
	2	85,600,266	1,254,584	American Intl Group Inc.			
	3	82,696,533	1,503,300	Wal Mart Stores Inc.			
	4	82,310,375	2,351,725	Pfizer, Inc.			
	5	79,167,310	1,447,300	Microsoft Corp.			
	6	72,823,442	1,779,654	Exxon Mobil Corp.			
	7	66,220,000	1,324,400	Anheuser Busch Companies, Inc.			
	8	65,196,142	1,302,360	Wells Fargo Company			
	9	62,333,500	845,200	Federal National Mortgage Assn.			
	10	55,874,560	1,091,300	Wyeth			

Additional investment information on the various pools and investments may be obtained from the Department of Revenue, Treasury Division, P.O. Box 110405, Juneau, Alaska 99811-0405.

**Teachers' Retirement System**  
**Schedule of Investment Management Fees**  
**Year Ended June 30, 2002**

	<b>Fair Value of Pooled Assets Under Management of all Retirement Funds in Pool as of June 30, 2002</b>	<b>Fees</b>
<b>External Management Fees</b>		
Domestic Fixed Income		
BlackRock Financial Management, Inc.	\$ 162,137,646	\$ 121,201
International Fixed Income		
Delaware International Advisers, Ltd.	<u>373,602,721</u>	<u>193,232</u>
Domestic Equity		
Capital Guardian Trust Co.	800,400,309	620,309
John McStay Investment Counsel	291,991,865	702,401
Trust Company of the West	202,029,294	164,940
State Street Global Advisors	905,790,905	82,837
Invesco Capital Management, Inc.	479,631,826	267,945
Lazard Freres Asset Management	402,010,037	523,106
McKinley Capital Management, Inc.	177,098,748	253,380
Dresdner RCM Global Investors	434,738,344	697,858
Tukman Capital Management, Inc.	<u>378,951,731</u>	<u>696,654</u>
Total Domestic Equity	<u>4,072,643,059</u>	<u>4,009,430</u>
Private Equity		
Pathway Capital Management, LLC	2,954,983	27,965
Abbott Capital Management, L.P.	<u>289,927,754</u>	<u>325,742</u>
Total Private Equity	<u>292,882,737</u>	<u>353,707</u>
International Equity		
Bank of Ireland Asset Management Ltd.	414,386,620	453,262
Brandes Investment Partners, L.P.	595,263,960	773,302
Citibank Global Asset Management	-	16,621
Lazard Freres Asset Management	433,662,307	502,007
Capital Guardian Trust Co.	393,171,522	419,064
Wellington Management Co.	<u>56,756</u>	<u>2,534</u>
Total International Equity	<u>1,836,541,165</u>	<u>2,166,790</u>
Emerging Markets Equity		
J.P. Morgan Fleming Asset Management	49,332,850	146,490
Capital Guardian Trust Co.	<u>58,728,508</u>	<u>126,590</u>
Total Emerging Markets Equity	<u>108,061,358</u>	<u>273,080</u>
Total External Management Fees	<u>\$6,845,868,686</u>	<u>7,117,440</u>



**Teachers' Retirement System**  
**Schedule of Investment Management Fees (con't)**  
**Year Ended June 30, 2002**

	<b>Fair Value of Pooled Assets Under Management of all Retirement Funds in Pool as of June 30, 2002 (con't)</b>	<b>Fees (con't)</b>
<b>External Management Fees (con't)</b>		
Other Management Fees		
Custodian		
State Street Corporation		<u>349,188</u>
Investment Advisory		
Callan Associates Inc.		22,805
The Townsend Group		<u>43,037</u>
Total		<u>65,842</u>
Investment Performance Measurement		
Callan Associates Inc.		<u>50,320</u>
Total Other Management Fees		<u>465,350</u>
Total Management Fees		<u>\$ 7,582,790</u>

<b>Teachers' Retirement System Investment Summary Schedule June 30, 2002</b>					
	<b>Teachers' Asset Allocation Policy</b>	<b>Range</b>	<b>Market Value</b>	<b>% of Asset Class</b>	<b>% of Total Assets</b>
<b>Participation in Pools Owning</b>					
<b>Fixed Income Securities</b>					
Domestic					
Short-Term Fixed Income Pool			\$ 2,369,308	0.20%	0.06%
Retirement Fixed Income Pool			1,135,621,076	95.34%	30.84%
External Domestic Fixed Income Pool			<u>53,230,362</u>	<u>4.46%</u>	<u>1.44%</u>
Total Domestic Fixed Income	31%	28-34%	1,191,220,746	<u>100.00%</u>	32.34%
International					
International Fixed Income Pool	<u>3%</u>	<u>2-4%</u>	<u>123,842,488</u>	<u>100.00%</u>	<u>3.36%</u>
Total Fixed Income Securities	<u>34%</u>	<u>30-38%</u>	<u>1,315,063,234</u>		<u>35.70%</u>
<b>Participation in Pools Owning</b>					
<b>Domestic Equities</b>					
<b>Small cap<sup>(1)</sup> and Alternative Investments</b>					
Domestic Equity Pool			320,957,790	22.79%	8.71%
Private Equity Pool			<u>15,700,992</u>	<u>1.11%</u>	<u>0.43%</u>
Total Small Cap Domestic Equities and Alternative Investments	9%	7-11%	<u>336,658,782</u>	<u>23.90%</u>	<u>9.14%</u>
<b>Large cap and Alternative Investments</b>					
Domestic Equity Pool-active			565,138,932	40.12%	15.33%
Domestic Equity Pool-passive			456,835,834	32.43%	12.40%
Private Equity Pool			<u>49,994,170</u>	<u>3.55%</u>	<u>1.36%</u>
Total Large Cap Domestic Equities and Alternative Investments	<u>32%</u>	<u>29-35%</u>	<u>1,071,968,936</u>	<u>76.10%</u>	<u>29.09%</u>
Total Domestic Equities	<u>41%</u>	<u>36-46%</u>	<u>1,408,627,718</u>	<u>100.00%</u>	<u>38.23%</u>
<b>Participation in Pools Owning</b>					
<b>International Equities</b>					
International Equity Pool			602,538,662	89.71%	16.35%
Emerging Markets Equity Pool			37,823,374	5.63%	1.03%
Private Equity Pool			<u>31,325,987</u>	<u>4.66%</u>	<u>0.85%</u>
Total International Equities	<u>18%</u>	<u>15-21%</u>	<u>671,688,023</u>	<u>100.00%</u>	<u>18.23%</u>
<b>Participation in Real Estate</b>					
Mortgages, net of allowances			58,178	0.02%	0.00%
Real Estate Pool			<u>288,941,030</u>	<u>99.98%</u>	<u>7.84%</u>
Total Real Estate	<u>7%</u>	<u>5-9%</u>	<u>288,999,208</u>	<u>100.00%</u>	<u>7.84%</u>
Total Invested Assets	<u>100%</u>		<u>\$ 3,684,378,183</u>		<u>100.00%</u>
<sup>(1)</sup> Includes only securities held by those managers with small cap mandates. Does not include small cap holdings which may be held in other managers' portfolios.					

**Teachers' Retirement System  
Credit Risk of Investments  
Pension Trust Funds  
(Expressed in Thousands)  
June 30, 2002**

	Category			Fair Value
	1	2	3	
Marketable debt securities				
Domestic fixed income	\$ 1,188,851			1,188,851
International fixed income	123,843			123,843
Equity securities				
Domestic equities	1,342,933			1,342,933
International equities	602,539			602,539
Emerging market equities		37,823		37,823
	<u>\$ 3,258,166</u>	<u>37,823</u>	<u>-</u>	<u>3,295,989</u>
Not Categorized				
Private equities				97,021
Real estate equities				<u>289,000</u>
Total investments not categorized				<u>386,021</u>
Total investments				<u><b>3,682,010</b></u>

The Governmental Accounting Standards Board (GASB) Statement No. 3 requires disclosure regarding custodial credit risk to indicate the chance of loss in the event a financial institution or third party holding the System's securities fails. Those investments represented by specific, identifiable securities are classified into three categories of credit risk: Category 1 — Insured or registered, or securities held by the State or its custodian in the State's name; Category 2 — Uninsured or unregistered, with securities held by the counterparty's trust department (if a bank) or agent in the State's name; and Category 3 — Uninsured and unregistered, with securities held by the counterparty, or by its trust department (if a bank) or agent, but not in the State's name. Category 1 is the highest level of safekeeping securities as defined by GASB.

The System's investments other than mortgage-related assets are represented by participation in investment pools rather than specific, identifiable securities. Although pooled investments represent the System's share of ownership in the pool rather than ownership of specific securities, all of the underlying securities in the pools are considered to be Category 1 as defined by GASB Statement No. 3, except: (A) investments in the mutual fund-like Emerging Markets Equity Pool which are considered to be Category 2, and (B) shares in the Private equity pool and the Real estate equity pool which, like the System's mortgage-related assets, are not transferable financial instruments and therefore cannot be categorized with regard to custodial credit risk.

**Alaska State Pension Investment Board  
Recaptured Commission Fees Received in FY 2002**

	<u>Domestic Equity</u>	<u>International Equity</u>	<u>Total</u>
PERS	\$ 399,190	273,573	672,763
TRS	199,507	136,267	335,774
Judicial	2,595	2,496	5,091
Military	<u>542</u>	<u>304</u>	<u>846</u>
Total	<u><b>\$ 601,834</b></u>	<u><b>412,640</b></u>	<u><b>1,014,474</b></u>

The Alaska State Pension Investment Board (ASPIB) entered into a commission recapture program in late June 1995 with three large block brokerage firms. A commission recapture program is a form of directed brokerage that allows the plan sponsor to “recapture” a portion of commission dollars paid to broker-dealer firms for executing trades. In June 1995, the large capitalization domestic equity managers were asked to participate in the program targeting 20% of their trading value. The equity managers were asked to consider best execution first and foremost, but encouraged to participate in the commission recapture program when possible. In July 1996, ASPIB raised the level of elective participation for the large capitalization domestic equity managers from 20% to 30% of total trading activity. At that time ASPIB also requested that small capitalization managers participate in the commission recapture program when the opportunity was available to them.

In January 1998, the Alaska State Pension Investment Board (ASPIB) augmented its commission recapture program to include external managers that conduct international equity trades. As a result, a portion of the commission recapture payments received since January have resulted from international equity trades.